No. 85-1465

Supreme Court, U.S.
FILED
APR 3 1986
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MARYLAND STATE TEACHERS ASSOCIATION, INC., ET AL.,
Petitioners,

v.

HARRY HUGHES, GOVERNOR OF MARYLAND, ET AL.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether public employees and teachers could reasonably and legitimately rely upon a purported statutory contract of "no change" in certain future pension benefits, where the pre-existing Maryland caselaw and other relevant "law of the place" incorporated into the alleged contract permitted legislative change and the area of pension costs and benefits continued to remain pervasively regulated and heavily troubled?

2. Whether Maryland's pension law changes could be deemed a severe and retroactive contract impairment, even though the Legislature did not affect prior earned benefits or most future benefits of employees and teachers, who, in fact, were compensated by pay increases that translated into higher pension benefits and by improvements to the integrity, flexibility and actuarial and fiscal soundness of the retirement systems?

3. If the statute is found to severely and retroactively impair a purely financial obligation outside the State's reserve powers, whether the legislation is nevertheless justified as reasonable and necessary to insure the stability of the retirement systems and the State's fiscal health?

4. Whether the judgment below should be affirmed on the alternative grounds (1) that no binding statutory contract was created; (2) that the employees and teachers furnished no consideration for a contract; (3) that the alleged contract was subject to a condition of reasonable containment of rising pension costs, a condition that, by 1984, had failed as a result of unforeseen developments; and (4) that the Petitioners were justly compensated for the impact of pension law changes?

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BRIEF IN OPPOSITION

Governor Harry Hughes, et al., Respondents, for reasons detailed herein, urge the Court to deny issuance of a writ of certiorari to the United States Court of Appeals for the Fourth Circuit to review the judgment in *MSTA v. Hughes*, ___ F.2d ___, No. 84-2213 (4th Cir. Dec. 5, 1985).

STATEMENT OF THE CASE

After years of study and of employee opposition to pension reform, the Maryland General Assembly in 1979 enacted comprehensive legislation in an attempt to control the runaway costs of the State Employees' and Teachers' Retirement Systems. Chapters 23 and 24, Laws of Maryland (1979). This statute (1) required advance-funding of future State pension liabilities; (2) established

for employees and teachers hired after December 31, 1979, a generally noncontributory "pension" system with a modified benefit schem., including a capped cost-of-living adjustment (COLA), and with integration of benefits with social security; and (3) sought to encourage transfers to the new system by "retirement" system members via a return of contributions.[1]

When the 1979 legislation was being considered by House and Senate Committees, public employee unions sought amendments in an attempt to assure their membership that no future changes to benefit plans of old system members would occur. Before voting to approve the amendments, the Committees sought advice from the State Attorney General's Office that the proposals would not preclude future legislative changes, including modi-

[1] As was the case prior to 1979, members of the State employees' and teachers' "retirement" systems (including employees of participating municipal corporations) contributed five percent or less of their salary to an "annuity" which, coupled with the totally State-funded "pension", formed their "retirement allowance." *See* Article 73B, § 1(16), (17), and (18), and § 81(16), (17), and (18). Eligibility for service retirement was obtained upon 30 years of service or at age 60 and a right to some retirement allowance "vested" upon five years service. Art. 73B, § 11(16) and § 86(10). That retirement allowance was computed by multiplying 1/55th (1.82 percent) of the member's "average final compensation" (his or her three highest salary years) by the number of years of creditable service. Special provisions also existed in the law as to death and disability benefits as well as an automatic, unlimited cost-of-living adjustment for retirees. Prior to 1969, the employee-funded "annuity" and the State-funded "pension" were set at equal amounts. For example, when the percentage applied to average final compensation was 1/70th (1.43 percent), that amount was based upon a 1/140th share from both the State and the member. However, since 1969, the employee's share remained at 1/140th, while the State provided additional funds in the budget for the employee's share as an "additional pension." In addition, since its inception in 1971, the COLA has been funded entirely by the State from appropriated funds, not by a member's contributions. JLEC Report at 26.

fication of the unlimited COLA. On February 22, 1979, the General Assembly's lawyer responded in writing by pointing to a 1976 Opinion of the Attorney General (61 *Opinions of the Attorney General* 746 (1976)), sanctioning even more stringent proposals, and the Court of Special Appeals opinion in *City of Frederick v. Quinn*, 35 Md. App. 626, 371 A.2d 724 (1977), on the legislative right to alter municipal pension plans. On the basis of this authority, the letter concluded that even earned pension benefits were subject to a reserved legislative power to make reasonable modifications "for the purpose of keeping the system flexible and maintaining its integrity" and that "this rule would also apply to legislative changes affecting cost-of-living adjustments, regardless of when the employee retires." As to future pension earnings, the letter noted that "the Legislature could modify such pension rights before they become a vested property right without regard to justifications rooted in fiscal integrity or reasonable modifications." *See MSTA v. Hughes*, 594 F. Supp. 1353, 1364 (D. Md. 1984).

Following the receipt of this advice, House and Senate committees adopted the amendments proposed by the unions, which provided that members of the old retirement systems, as of December 31, 1979, who did not join the new pension system, would remain in the old system "as a condition of that person's employment contract . . . without change in . . . benefits."[2] Despite

[2] The amendment, which amounted to less than two pages of a 80-page bill, went on to provide that the relevant benefits included: (1) The eligibility for service retirement upon completion of 30 years service or attainment of age 60; (b) The eligibility for a reduced service retirement upon completion of a certain length of service; (c) The service retirement allowance of one fifty-fifth of average final compensation; (d) The retirement allowance provided for ordinary or accidental disability; (e) The selection of options for service or disability allowance; (f) The adjustment of the retirement allowance for increases in the consumer price index; (g) The death benefit; (h) The level of contributions from members; and (i) The length of service for members to vest benefits in the system.

the amendments, union opposition to the measure persisted. However the legislation was enacted.

Spread across the legislative record and included in reports, fiscal notes and actuarial analyses were the 1979 General Assembly's hopes for pension reform and its reasonable expectations as to future State costs, transfers into the new system, inflation, and the non-precipitous growth of unfunded accrued pension liabilities. *See* 1979 House Journal 1385-1413. For example, a "fiscal note" prepared for the legislation[3] disclosed that total costs of all the retirement and pension systems as a percentage of payroll would level off at 11.66 percent and continue at that rate through the year 2020 and that dollar costs would range from $254.3 million in Fiscal 1981, to $345.8 million by fiscal year 1985. 1979 House Journal 1398. Additional annual costs as a result of the legislation were forecast at $32.1 million for fiscal year 1981 up to $35.9 million in the mid-eighties, with a drop in net costs occurring sometime before the year 2000. *Id.* It was also forecast that the unfunded accrued liability of the systems, which, as of June 30, 1978, valuation stood at $2.8 billion, 1979 House Journal at 1412, would not reach $5 billion until the year 2000. According to the fiscal notes, "[a] key assumption used in the actuarial analysis is that approximately 40 percent of the present membership in the Employees and Teachers Pension Systems will elect to transfer to the new systems." 594 F. Supp. at 1365. With the stability forecast in these figures, it was no wonder that the Governor in his end-of-session message to the 1979 General Assembly could say that "by reforming a runaway State pension system," what we have accom-

[3] Pension bills are ordinarily required by law to contain a fiscal note containing an estimate of the fiscal impact and an actuarial analysis of the legislation. *See* Md. Code, State Government Article, § 2-1505. Generally, a vote may not be taken on such legislation by a standing committee without a fiscal and actuarial analysis. *Id.*

plished "is to begin the process of laying a foundation for sound fiscal planning and management for the years to come." 1979 House Journal at 3953.[4]

These expectations were soon dashed. First, as State officials advised New York bond rating houses of the new stability of the Maryland retirement systems, public employee unions began a successful campaign to keep old system members from transferring into the new system. As a result, only 18 percent of teachers and 32 percent of State employees opted for the new system. 594 F. Supp. at 1365.

Second, a 1980 "experience investigation" by the State's actuary of the teachers' retirement system disclosed that certain actuarial assumptions embodied in the 1979 cost projections were incorrect and that teachers were retiring earlier in greater numbers to obtain the unlimited COLA. This necessitated an increase in the State's contribution of 3.42 percent of payroll phased in over a three-year period. 594 F. Supp. at 1365.

Third, because of a drafting error in the 1979 legislation and because of the different demographic characteristics of their workforce, municipal corporations participating in the State retirement system suddenly faced millions of dollars more in unexpected costs. And a moratorium had to be imposed administratively on municipality payments to the system. 594 F. Supp. at 1366.

Fourth, in 1981, the State's actuary advised that the 1979 projection of costs erroneously computed the COLA for retirement system members on a simple rather than a compound basis. 594 F. Supp. at 1366. The error was not

[4] Shortly after the legislation was enacted and before it took effect, the General Assembly took the additional step of establishing a Joint Committee on Pensions "to continue the study of pension reform and to propose necessary future legislation."

just a one-year problem. It essentially required more than a $30 million increase in the 1983 fiscal year State budget and comparable amounts for State advance funding of pension costs for the next 40 years, or an estimated $1.2 billion. *Id.* at n.7. Unfunded accrued liabilities for the systems for a single year immediately increased by $578 million. *Id.* In addition, $16 million in higher appropriations had to be found in the 1982-83 budget to pay for these costs, thereby causing a cut-back in anticipated State spending for social welfare.

Further aggravating the COLA problem was a totally unexpected and drastic increase in inflation. On the basis of the Labor Department CPI, retirees received increases of 11.3 percent in 1981, 13.5 percent in fiscal 1982, and 10.4 percent in fiscal 1983.[5] Report of Joint Legislative and Executive Committee on Pensions (JLEC Report) at 27. These were increases that dwarfed the actuary's reasonable (and present) assumption of five percent and generated an enormous actuarial loss, escalation of unfunded accrued liabilities, and higher annual appropriations for pension costs. The end result of these developments was a quarter of a billion dollar difference between 1979 projected State costs and actual costs as of fiscal year 1984. Unfunded accrued liabilities exceeded $5 billion, JLEC Report at 63 — almost 20 years earlier than anticipated.[6] In December 1982, the State was told by its

[5] When the "two-tiered" pension system proposal was taking shape in the General Assembly in the late seventies, inflation was at a moderate rate. Although the cost-of-living rose in 1979 when the pension reform legislation was being enacted, various economists and even the President were forecasting a reduction in inflation. *See e.g. 1979 Public Papers of President Jimmy Carter, News Conference of Feb. 12, 1979* at 156.

[6] State unfunded accrued liabilities per active member rose from $19,831 in 1980 to $34,512 in 1983. JLEC Report at 67. In addition, by 1983, Maryland ranked second in the Nation with a per capita unfunded pension liability burden of $1,256.82 — higher than the per capita tax burden, the per capita State debt burden, or per capita State expenditures. *See* Prudential-Bache

actuary that an additional $103 million in appropriations was needed to fund the various retirement and pension systems in fiscal year 1984. JLEC Report at 55. As a result, the Governor announced that there would be no State employee pay increase that year and less money for social services and other programs. In addition, agency spending cuts were ordered.

The very next session, Senate Bill 606, which would have computed future years' benefits for employees and teachers in the old system in accordance with the new system formula (including a three percent COLA), was introduced and was passed in the Senate over union opposition. However, the House refused to act upon the bill, claiming that the issue deserved further study and that pension changes should not occur without an employee pay increase. After the failure of Senate Bill 606, the Governor named a Joint Legislative and Executive Committee on Pensions ("JLEC"), composed of legislative veterans of past pension reform efforts and certain executive branch officials, as well as an advisory body consisting of members of the employees' unions, to address a wide range of pension reform and cost containment issues. Executive Order 01.01.1983.10. Before the JLEC issued its recommendations, members of the House suggested and the Committee adopted a compromise of the 1983 legislation — a "menu" of options for old system members (none of which affected existing retirees), including a two percent increase in employee contributions that would preserve all benefits including an unlimited COLA.[7]

Securities, *A Special Report: The Fifty States — Financial Condition and Economic Outlook* (Sept. 1983) at 50-51.

[7] Under the "menu" approach, old system members were offered four choices: (1) the "bifurcated" option embodied in Senate Bill 606 of 1983, *viz.*, preservation of all prior years' benefits already earned under the old system with future years computed under the new, noncontributory system; (2) continued

In addition to the COLA legislation (H.B. 991, enacted into law as Chapter 7, 1979 Laws of Maryland), the JLEC proposed a number of additional reforms clearly designed to benefit employees. JLEC Report at 1. These included removing certain pension fund investment limitations, using contributions from the new systems to insure the solvency of the old, changing the actuarial cost method to stabilize future funding and extending a moratorium on the accrued liability payments of local governments participating in the State systems. (H.B. 1664, enacted into law as Chapter 290, 1984 Laws of Maryland). The Administration proposed this comprehensive pension reform package along with a six percent pay raise for State employees and a five-year commitment of State spending for education. A large portion of the latter was clearly intended for teacher salary increases that by operation of law acted to raise pension benefit levels. *See* Md. Code, Art. 73B, § 1(15) and § 81(15). Despite intense opposition by teachers and employees House Bill 991 was enacted, clearing the way for passage of House Bill 1664 and these pay initiatives.[8]

On April 10, 1984, six employee unions and 19 teachers and public employees brought a class action in the United States District Court in Maryland challenging only one

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contribution of five percent with a five percent COLA cap; (3) retention of the unlimited COLA but an additional contribution of two percent; and (4) transfer to the new system with a refund of contributions. If a member failed to make any choice by the cut-off date, his or her benefits would automatically be bifurcated. Just as was the case under Senate Bill 606, the "menu" approach did not affect the benefits of those who retired before the effective date of the legislation.

[8] Before passage, the bill was amended in ways designed to additionally benefit the members of the system. One amendment required the savings from the first year to be applied to the unfunded accrued liability. A second amendment increased the interest paid on the return of contributions to members who chose to transfer to the pension systems.

component of this pension reform and salary enhancement package for State employees and teachers, *viz.* House Bill 991. Their principal contention was that the bill unconstitutionally impaired a contract purportedly created in 1979. In return for agreement to an expedited schedule, and, if the State prevailed, post-judgment implementation of the statute in accordance with its July 1, 1984 effective date, the State consented to the entry of a preliminary injunction halting operation of the law. Cross motions for summary judgment were filed and following argument, the Court, in a September 17, 1984 order, granted the State's motion. On September 25, 1984, the Court issued an opinion which concluded that if a contract had been created in 1979, it was not impaired by the 1984 legislation. *MSTA v. Hughes,* 594 F. Supp. 1353 (D. Md. 1984). Apparently, to avoid reconciling Maryland court decisions that undercut the existence of a statutory contract of "no change" in State pension benefits,[9] with a

[9] In *Mazor v. Dept. of Corrections,* 30 Md. App. 394, 352 A.2d 918 (1976), *aff'd* 279 Md. 355, 369 A.2d 82 (1977), the Court of Special Appeals of Maryland held that because of the clear distinction in Article 73B of the Maryland Code between a State funded "pension" and an "annuity" based on employee contributions, a State pension was a gratuity not a contract, even in the face of statutory language making a pension and an annuity "obligations of the State." The State's highest court affirmed. Relying upon *Flemming v. Nestor,* 363 U.S. 603 (1960), the judges noted:

> "To engraft upon the pension . . . program . . . a concept of accrued property rights would deprive these programs of the 'flexibility and boldness in adjustment to ever-changing conditions' which they demand." 279 Md. at 366, 369 A.2d at 90.

Other Maryland cases also cast doubt on Petitioners' statutory contract, of "no change" in benefits, *viz., Westminster Water Co. v. Westminster,* 98 Md. 551, 56 A. 99 (1904) (A permanent contract binding legislative powers is *ultra vires*); *Kimball-Tyler v. Baltimore City,* 214 Md. 86, 133 A.2d 433 (1957) (Detrimental reliance is insufficient consideration to support a statutory contract); *Canal Co. v. Rail Road Co.,* 4 G. & J 1 (1832) (Use of word "contract" is irrelevant on whether a contract exists); and

1977 intermediate appellate court decision that concluded that a municipal pension was a contract protecting earned benefits but one subject to a reserved legislative power to change, *City of Frederick v. Quinn,* 35 Md. App. 626, 371 A.2d 724 (1977), the District Court assumed "without deciding" that a contract existed, *MSTA v. Hughes, supra,* 594 F. Supp. at 1362. Incorporating *Quinn* into the employees' and teachers' asserted contract, the Court held that it was subject to legislative change and protected no more than pro rata earned benefits. In light of this latter feature of the contract, the Court concluded the 1984 statute resulted in neither a retroactive nor a severe impairment. 594 F. Supp. at 1362-1364.[10] The Court also stated that *if* the employees' and teachers' contract of no change was immutable, the State would have surrendered an essential attribute of State sovereignty, *viz.* control over compensation for future services. 594 F. Supp. at 1362 and 1364. However, the Court added that "the plaintiffs, presumably recognizing the preposterousness of a position that a contract of this type is irrevocable, admit that the contract asserted to exist here may be altered."

Rittenhouse v. Baltimore, 25 Md. 336, 346 (1886) (No contract obligation arises from those acts "necessarily connected with or growing out of [the governmental entity's] public capacity.").

[10] The Court also found no severe impairment as a factual matter. It specifically rejected Petitioners' contentions that the "menu" option increasing the contribution rate from five to seven percent resulted in a 40 percent rate increase. Quoting from the affidavit of the State's actuarial expert, the Court said:

> "Past contributions made by the affected members are not adjusted; for example, a member who has already contributed to the Retirement System at 5% for twenty-five years and has five years to go would only contribute an additional 12% (rather than 40%) in *total* contributions." 594 F. Supp. at 1364.

The Court also emphasized the conclusions of the State's actuary that using the methodology and assumptions of Petitioners' expert, "the 'worst case scenario' of the 7% option results in a *maximum* benefit loss of well under two percent for any current member of the Retirement Systems." *Id.*

594 F. Supp. at 1362. Finally, the Court concluded that even if the impairment were substantial, the 1984 pension reform legislation was reasonable and necessary to serve important public purposes, such as enhancing the actuarial soundness of the retirement systems, the predictability of its costs, and State planning of its fiscal strategies. *Id.* at 1369-1370.[11] On December 5, 1985, the United States Court of Appeals for the Fourth Circuit affirmed in a brief per curiam opinion, with all judges in agreement that the State had acted in good faith and had justified the need for pension law changes. *See* concurring opinion of Judge Murnaghan. *See* Petition for Writ of Certiorari at 5a-6a.

ARGUMENT

I.

NO SUBSTANTIAL FEDERAL QUESTION IS PRESENTED BY THE LOWER COURT'S DECISION THAT THE MARYLAND CASELAW THAT FORMED PART OF THE PURPORTED STATUTORY CONTRACT PERMITTED THE LEGISLATIVE MODIFICATIONS AT ISSUE.

This Court has long held that in determining the existence and extent of a statutory contract alleged to be protected by Article I, § 10 of the United States Constitution, it "will treat it as if there was embodied in their text the settled rule of law which existed in the state at the time the state action relied upon as a contract was taken." *Ennis Water Works v. Ennis,* 233 U.S. 652, 657-658 (1914); *see also United States Trust Co. v. New Jersey,* 431 U.S. 1, 19, n.17 (1977); *Von Hoffman v. City of Quincy,* 4 Wall. 535, 550 (1867). Although the petition for

[11] Following the District Court decision, the State announced plans to implement the 1984 law with a six-month election period beginning November 11 1984, and to return old system members to the status quo should it not prevail on appeal. Upon representation of this arrangement to the Court, the District Judge denied Petitioners' request for a stay. Thus, the 1984 legislation has been in effect for nearly 18 months.

certiorari gives little hint of it, this principle, along with the strong factual justification offered by the State in support of the 1984 pension law changes, determined the outcome below. In short, Maryland caselaw, most notably, *City of Frederick v. Quinn,* 35 Md. App. 626, 371 A.2d 724 (1977), permitted legislative modification of a pension "contract" in Maryland and sanctioned the statutory changes attacked by Petitioners.[12]

The state common law governing public employee pension rights and the legislative power to alter benefits varies from jurisdiction to jurisdiction. Some state courts cling to the notion that a public employee pension is not a contract but a gratuity that can be altered at the Legislature's will. *See e.g., Creps v. Board of Firemen's Relief and Retirement Fund Trustees,* 456 S.W.2d 434 (Tex. Civ. App. 1970). However, in contrast to the treatment of federal retirees, *see Zucker v. United States,* 758 F.2d 637 (Fed. Cir. 1985), *cert. denied,* 106 S. Ct. 129 (1985), the clear trend of state court decisions is to offer some measure of protection for employee pension rights. A few courts hold that pensions are contractual in the sense that rights vest unconditionally and may not be legislatively altered even to make plans more fiscally sound. *See e.g., Yeazell v. Copins,* 402 P.2d 541 (Ariz. 1965). Others reject this rigid "contract" approach in favor of treating pensions as a "property right," *see e.g., Pineman v. Oechslin,* 488 A.2d 803 (Conn. 1985) or as governed by a theory of "promissory estoppel," *Christensen v. Minneapolis Municipal Employees Retirement Board,* 331 N.W.2d 740 (Minn. 1983). A growing number of jurisdictions characterize a pension as a contract, but one permitting only limited vesting rights and containing an

[12] In addition to the Maryland cases, various provisions of the Maryland Constitution and statutes undercut the Petitioners' ability to rely on a contract of no-change in future benefits. *See* n.16, *supra.*

implied term reserving legislative power to make reasonable modifications. *See e.g., Lyon v. Flouring,* 76 Cal. Rptr. 869 (Cal. App. 1969), *appeal dismissed for want of a substantial federal question,* 396 U.S. 274 (1970).[13]

Even those state courts that treat a public employee pension as a contract or subject to reasonable modification differ as to what rights are protected by the contract and what modifications are permitted. For example, some state courts permit an increase in employee contributions, *see e.g., Houghton v. City of Long Beach,* 330 P.2d 918 (Cal. App. 1958); others do not, *Association of Pennsylvania State College and University Faculty v. State System of Higher Education,* 479 A.2d 962 (Pa. 1984). Some jurisdictions protect only accrued or earned benefits, *see e.g., In re Enrolled Senate Bill 1269,* 209 N.W.2d 200 (Mich. 1973); others protect some future benefits, *Pasadena Pol. Off. Ass'n v. City of Pasadena,* 195 Cal. Rptr. 339 (Cal. App. 1983). Some courts hold that a pension contract does not prevent reduction of appropriations for such plans, *see e.g., Illinois Fed. of Teachers v. Lindberg,* 326 N.E.2d 749 (Ill. 1975), *cert. denied,* 423 U.S. 839 (1975); others reach an opposite conclusion, *see Valdez v. Cory,* 189 Cal. Rptr. 212 (Cal. App. 1983). Some say there are no pension rights until all eligibility requirements, including years of service, are satisfied, *McFeely v. Pension Comm'n,* 73 A.2d 757 (N.J. Super. 1950); others hold that rights vest upon employment, *Smith v. City of Dothan,* 188 So. 2d 532 (Ala. 1966).[14]

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[13] The apparent forerunner of the "reasonable modification" approach can be found in this Court's decisions on the amendment of corporate charters. *See Shields v. Ohio,* 95 U.S. 319, 324-25 (1877) ("The power of alteration and amendment is not without limit. The alterations must be reasonable; they must be made in good faith, and be consistent with the scope and object of the Act of incorporation.").

[14] The States of Alaska, Illinois, Michigan and New York have written into their constitutions provisions protecting

Which particular state common law approach to public employee pension benefits is adopted in a particular jurisdiction is, of course, utterly crucial to a judicial finding of whether legislative change is permissible. Yet this widespread diversity has never deterred this Court from looking to this "law of the place" to determine the existence and extent of a purported pension contract in a Contract Clause challenge to state pension law changes. *See Minneapolis Police Relief Association v. Sundquist,* 104 S. Ct. 1902 (1984) (mem.) (upholding a two percent increase in employee contributions); *Allen v. Bd. of Adm. Publ. Emp.,* 104 S. Ct. 1262 (1984) (mem.) (upholding pension law changes decided below under "reasonable modification" approach); *Lyon v. Flouring,* 396 U.S. 274 (1970) (mem.) (upholding pension law change on "reasonable modification" theory); *Dodge v. Board of Education,* 302 U.S. 74 (1937) (Rejecting a Contract Clause challenge to actual reduction in retiree benefits on a "no contract" theory.).[15]

public employee pension rights. For a discussion of the various common law approaches to public employee pension benefits, *see Pineman v. Oechslin,* 637 F.2d 601, 604-05 (2nd Cir. 1981); *Pineman v. Oechslin,* 488 A.2d 803 (Conn. 1985); Note, "Public Employee Pensions in Times of Fiscal Distress," 90 Harv. L. Rev. 992, 998-1005 (1977); Annot: "Vested Right of Pensioner to Pension," 52 A.L.R.2d 430 (1957) (and Supplement).

[15] There is nothing in *United States Trust Co. v. New Jersey,* 431 U.S. 1 (1977) that remotely suggests that state common law need no longer be examined to determine the existence and terms of a pension contract. That decision reaffirms the "law of the place" tenet and recognizes that amendment or modification of a statutory contract is permissible. 431 U.S. at 19. *See* Schwartz, "Old Wine in Old Bottles: The Rennaissance of the Contract Clause," 1979 S. Ct. Rev. 95, 99. The reason this Court did not have to look to state law in *United States Trust* was that "the settled rule of decisions" in the Supreme Court, Hale, "The Supreme Court and the Contract Clause: III," 57 Harv. L. Rev. 852, 869 (1944), including 100-year old precedent on the enforcibility of bond contracts, 431 U.S. at 24-25, n.22 and n.23, made such an inquiry utterly unnecessary. Moreover, summary dispositions in public employee pension law cases both before

What did the lower courts find when they examined the Maryland "law of the place" incorporated into Petitioners' alleged statutory contract? They found Maryland precedent concluding that public employee pension rights were contractual to the extent that "future benefits vested as they were proratedly earned," *City of Frederick v. Quinn, supra,* 35 Md. App. at 630. But under *Quinn* even earned benefits could be changed:

> The pension plan is not immutable and the government-employer need not keep its provisions precisely intact. As government grows in size and complexity and as more employees draw from the fund, changes must often be made to assure the soundness of the fund and permit its growth commensurate with its prospective needs. The contractual or vested rights of the employee in Maryland are subject to a reserved legislative power to make *reasonable modifications* in the plan, or indeed to modify benefits if there is a simultaneous offsetting new benefit or liberalized qualifying condition. Each case where a changed plan is substituted must be analyzed on its record to determine whether the change was reasonably intended to preserve the integrity of the pension system by enhancing its actuarial soundness, as a reasonable change in promoting a paramount interest of the State without serious detriment to the employee. In short, the employee must have available substantially the program he bargained for and any diminution thereof must be balanced by other benefits or justified by countervailing equities for the public's welfare. *Id.* at 630-31. (Emphasis in original).

See also Baker v. Baltimore County, 487 F. Supp. 461 (D. Md. 1980) *aff'd,* 660 F.2d 488 (4th Cir. 1981) (Applying the reasonable modification test of *Quinn* to changes in a

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and after *United States Trust* make it clear that the "law of the place" and the legislative power to amend pension contracts, are principles that are still very much alive in this area of the law.

contributory municipal pension plan that resulted in an increase in contributions and a capped COLA). The 1979 Maryland General Assembly was aware of its power under *Quinn* to make reasonable modifications, *see* pp. 2-3, *supra;* and the 1984 General Assembly structured its pension reform legislation to accommodate this standard. It gave teachers and employees the option of preserving earned benefits and sought in good faith to substitute member benefits and to preserve the actuarial and fiscal soundness of the retirement systems. *See MSTA v. Hughes, supra,* 594 F. Supp. at 1364, 1368 and 1370. The State submits that the settled law of Maryland[16] permitted the legislative changes challenged by the Petitioners, that two federal courts have applied that law correctly, *see Bishop v. Wood,* 426 U.S. 341, 346 (1976), and that no substantial question is raised by this particular federal determination of State law, *see* Hale, "The Supreme Court and the Contract Clause: III," 57 Harv. L. Rev. 852 (1944), that predetermined the course of this litigation.

[16] Maryland caselaw is no less "settled" because of the possible conflict between *Quinn,* which held a *municipal* pension right enshrined in a charter to be a contract subject to reasonable legislative modification, and *Mazor v. Department of Corrections, supra,* which found a *State* pension to be a gratuity. *See* n.9, *supra.* Both cases accord the legislative body wide latitude in making pension law changes. And although if the issue were before the Court, it would not "assume" the existence of a contract, as Petitioners urge here, and would attempt to resolve the differences in the cases, *see Dodge v. Board of Education,* this certainly is not much of a reason to grant review here.

It is also important to note that other features of the law of Maryland besides *Quinn* militate against easy reliance on a contract of "no change" in pension benefits. Maryland has no impairment of contract clause in its Constitution or a provision preserving public employee pension benefits. Rather, in its Constitution, the State reserves to the people "the exclusive right of regulating the internal government," Article 4, Md. Decl. of Rights; and prevents the Legislature from pledging the credit of the State in aid of individuals, Article III, § 34. In

II.

THE DECISIONS BELOW ARE FULLY CONSISTENT WITH CASES OF THIS COURT AND ARE NOT IN CONFLICT WITH HOLDINGS IN ANY FEDERAL CIRCUIT OR THE HIGHEST COURT OF ANY STATE.

Petitioners strain to find a purported conflict between the decision of the United States Court of Appeals for the Fourth Circuit and cases of this Court as well as those of certain State and federal courts. However, an examination of these decisions reveals no conflict grounded in an interpretation of federal constitutional law. Indeed, as the State has argued above, any conflict in jurisdictions is premised on the "law of the place," not on a variance in the constitutional principles applied to statutory pension contracts.

The employees and teachers assert that the courts below erroneously and singularly concluded that the alleged contract of no change in benefits was "void ab initio" as surrendering an essential element of sovereignty reserved to the states. This is, at best, an overstatement. What the District Court said was that *if* the alleged contract *irrevocably* waived the State's ability to modify the law with respect to *future* pension benefits, it would have constituted a surrender of reserved power. *See MSTA v. Hughes, supra,* 594 F. Supp. at 1362. Because the Maryland caselaw that formed part of Petitioners' contract permitted legislative change, the lower court did not have to decide and, in fact, did not decide a reserved power issue. Nor did the court below give undue deference to the 1984 pension law changes because the purported contract

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addition, in Maryland, State employees do not have "employment contracts" to which a pension benefit could attach and by statute payment of teacher pensions are merely a State grant for aid to education in the counties. *See* Md. Code, Education Article, § 5-201. Finally, Maryland caselaw views as *ultra vires* an attempt by a government body to formally bind itself in perpetuity in the exercise of its governmental powers. *Westminster Water Co. v. Westminster,* 98 Md. 551 (1904).

touched an area of reserved power. Even though it concluded that no substantial contract impairment existed, the District Court nevertheless painstakingly and at length analyzed the justifications for the 1984 law and the problems that led to its enactment to insure that the State's self-interest was not at stake. In short, there was no error in the lower court's application of the reasonable-and-necessary test of *United States Trust* to the facts of this case and in its conclusion that those facts afforded a further ground for upholding the Maryland statute.

Even if the decisions below had rested totally on a finding that Petitioners' alleged contract of "no change" in future pension benefits invaded the State's reserved powers, such a conclusion is not at odds with any decision of this Court. Both *Butler v. Pennsylvania,* 10 How. 400, 417 (1851), and *Newton v. Mahoning County,* 100 U.S. 548 (1879), suggest that in some respects a state's control over the compensation paid its employees cannot be surrendered away by contract. These cases and later decisions of this Court recognize a distinction between compensation contracts for past services and those for future services, as well as those of a short-term and long-term nature. For example, *Butler* (and later *Crenshaw v. United States,* 134 U.S. 99, 106 (1890)) states that:

> The promised compensation for services actually performed and accepted during the continuance of the particular agency may undoubtedly be claimed, both upon principles of compact and of equity; but to insist beyond this on the perpetuation of a public policy either useless or detrimental, and upon a reward for acts neither desired nor performed, would appear to be reconcilable with neither common justice nor common sense.

See also Hall v. Wisconsin, 103 U.S. 5 (1880), holding that a compensation agreement for services actually performed "during a limited period" pursuant to a statutorily-mandated written contract was protected by the Contract

Clause, *id.* at 10; and *Local Div. 589, etc. v. Comm. of Mass.*, 666 F.2d 618, 641 (1st Cir. 1981), *cert. denied*, 457 U.S. 1117 (1982), indicating that:

> [T]he state can override a promise by one of its authorities made several years before that ties the hands of all future legislatures in an area of great importance to the public, concerning serious problems (labor/wage/cost/efficiency negotiations) where few would claim to have found even a provisionally satisfactory answer, let alone a permanent one.

The lower courts here have espoused these very same principles, suggesting only that a permanent contract foreclosing any modification of future rather than earned pension benefits would raise reserved power concerns.

This well-recognized dichotomy between future or past compensation and long and short-term public employee compensation arrangements disposes of Petitioners' ill-founded fears that denial of review here will encourage states to dishonor public employee collective bargaining agreements — agreements that are invariably in effect for only a limited time — and distinguishes all of the collective bargaining cases that are purportedly in conflict with the decision here.[17]

Finally, it should be noted that on every occasion this Court has considered the merits of cases involving changes in government pension plans challenged on a Contract Clause-type of theory, it has upheld the legislative action.

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[17] There are, of course, more compelling reasons to apply the reserved powers doctrine to legislative changes of future pension benefits, rather than mere compensation contracts, because of the far-reaching impact of such pension plans on a State's fiscal health, its bond rating, and the compensation and welfare of its employees. *See AFSCME Councils 6, 14, 65 and 96 v. Sundquist*, 338 N.W.2d 560, 571, n.15 (1983), *appeal dismissed for want of a substantial federal question*, 104 S. Ct. 1902 (1984). However, the question is not presented in this case.

See Minneapolis Police Relief Association v. Sundquist, supra; Allen v. Bd. of Adm. Publ. Emp., supra; Lyon v. Flouring, supra; Dodge v. Board of Education, supra; Pennie v. Reis, 132 U.S. 464 (1898); *United States v. Teller,* 107 U.S. 64 (1883). The State submits that the decisions below are fully consistent with this Court's past treatment of the constitutionality of public employee pension law changes and raise no genuine conflict with any other state or federal case.[18]

[18] Little need be said with respect to an asserted conflict between the Fourth Circuit decision and *Indiana ex rel. Anderson v. Brand,* 303 U.S. 95 (1938). Although decided under the aegis of the Contract Clause, the latter case is simply a forerunner of modern procedural due process cases and First Amendment cases on political firings. It has nothing to do with the issues presented by Petitioners.

Finally, the Petitioners contend that a conflict exists between this and state court cases as to whether the reasonable-and-necessary standard of *United States Trust* can be met by asserting "financial reasons." In doing so, petitioners seek to characterize actuarial soundness, and enhancement of the State's ability to accurately plan fiscal strategy as "financial reasons," thereby stretching the term far beyond the meaning it had in *United States Trust,* where this Court said that "a state cannot refuse to fulfill its financial commitments simply because it would prefer to spend the money for some other purpose." The cases cited by Petitioners do not reveal any conflict worthy of reconciliation by this Court. Two of the cases cited, *Continental Illinois National Bank & Trust Co. v. State of Washington,* 696 F.2d 692 (9th Cir.) *appeal dismissed,* 460 U.S. 1077 (1983); and *Carlstrom v. State of Washington,* 694 P.2d 1 (Wash. 1985), in fact involve a bare desire on the part of the state to spend less money. Two other cases, *Ass'n of Pa. State College v. State System,* 479 A.2d 962 (Pa. 1984); and *Singer v. City of Topeka,* 607 P.2d 467 (Kan. 1980), turn on questions of state law, and do not reach the issue of reasonableness and necessity. *Miles v. Tenn. Consol. Retirement System,* 548 S.W.2d 299 (Tenn. 1976), did not reject the State's asserted purpose of alleviating the funding problems of the pension system, but instead found there had been no factual showing that alleviating the funding problems would protect a vital interest of the state. 548 S.W.2d at 305. Finally, in *Marvel v. Dannemann,* 490 F. Supp. 170 (D. Del. 1980), the court recognized that protection of the fiscal integrity of the fund would serve a substantial and important

III.

NO SUBSTANTIAL FEDERAL QUESTION IS RAISED AS TO WHETHER AS A FACTUAL MATTER PETITIONERS' PENSION CONTRACT WAS IMPAIRED OR WHETHER THE STATE FACTUALLY JUSTIFIED THE NEED FOR CHANGES IN MARYLAND PENSION LAW.

The courts below found no contract impairment both as a legal and a factual matter. Because under Maryland law only "earned" benefits were within the employees and teachers' "contract" and the only non-voluntary option in the 1984 statute (the "bifurcated" option) preserved such benefits, no impairment of a contractual obligation resulted. In part, the District Court characterized this operation of the 1984 law as a prospective rather than retroactive change. Rather than treating the issue in terms of retroactivity, the lower court could have just as easily couched this conclusion as a finding of no contract for future benefits or of no impairment of a contract right, *see In re Enrolled Senate Bill 1269,* 209 N.W.2d 200 (Mich. 1973). Regardless of the characterization, the result is the same, the 1984 statute does not offend the Contract Clause. Moreover, in light of the Maryland cases permitting legislative alteration of benefits, the pervasive State regulation of pensions, including the ongoing study by the Maryland General Assembly of the 1979 pension reform act with an eye toward future changes, and the almost instantaneous troubles the systems experienced,

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public interest, and that it could justify modifications of a pension plan. 490 F. Supp. at 176 and n.6. However, under the facts of that case the court found that the purpose was not to increase the fiscal integrity of the fund, but to provide that public funds would bear less of the cost. In the case at hand, the court found that the actual purpose of the legislation was to enhance actuarial soundness and to allow more accurate fiscal planning. Nothing in the cases cited by Petitioners indicates that these purposes cannot satisfy the test of reasonableness and necessity.

the Petitioners could have no reasonable expectation that the 1979 law would remain unchanged.

Other factors mandated the finding of no substantial impairment. The 1979 statutory "contract" was neither repudiated nor repealed. Only a few of the ten benefits enumerated in the alleged contract were affected by the 1984 legislation. And limiting the COLA and increasing contributions can be "reasonable modifications" to a pension system. *See Baker v. Baltimore County,* 487 F. Supp. 461, 470 (D. Md. 1980), *aff'd,* 660 F.2d 488 (4th Cir. 1981) (Applying Maryland law).

Unique problems are posed by an unlimited cost-of-living adjustment, particularly in Maryland where the cost of the benefit has been totally State-funded. It is a highly volatile benefit that defies predictability of annual costs and responsible planning; it results in lack of growth in funds commensurate with system needs; and it results in too many years when system assets will not exceed liabilities by a comfortable margin.[19] Placing a three percent ceiling on such a benefit contributes to alleviating

[19] Maryland is the only state with an unlimited COLA and the only state advance-funding such a benefit. The effects have been painful and apparent. Since 1975, there have been no major benefit packages for system members, particularly placing members of the new pension system at a comparative disadvantage. Pay increases were becoming increasingly erratic with a resultant adverse impact on the systems. This is so because a pay raise increases the payroll base that funds pensions and annuities; the lack of one results in an "actuarial loss." In the meantime, Maryland has acquired a per capita burden of unfunded pension liabilities that is second in the Nation. It is also noteworthy that critics of the federal employees pension system blame its unlimited COLA for high costs. *See* Committee on Post Office and Civil Services, House of Representatives, "Designing a Retirement System for Federal Workers Covered by Social Security," Comm. Print 98-17, 98 Cong. 2d. Sess. (Dec. 1984) at 85. The latter study notes that private pension plans were indexed to inflation only to about 30 percent. *Id.*

these problems. *MSTA v. Hughes, supra,* 594 F. Supp. at 1368 ("One need not be an actuary to conclude that predictable cost-of-living increases for future retirees stabilizes cash in-flow and out-flow projections, allows for sounder investment strategies, and provides a more predictable basis for actuarial assumptions."). Thus, the lower courts found not only that the 1984 pension law changes were a "reasonable modification," but also reasonable and necessary to serve important state purposes.

Because the Legislature took pains to consider the interests of teachers and employees by developing a "menu" of options for them, it took a future risk for the State by retaining the volatile unlimited COLA for members willing to make a small additional contribution toward retirement costs from their fiscal 1985 pay raise. Nevertheless, this option is a reasonable system modification and no severe burden for employees and teachers. Their contribution rates rose only from five to seven percent. Under Maryland law, State police are presently paying eight percent. Md. Code, Art. 88B, § 56(1)(b). Federal employees pay seven percent. Increased contributions are not deposited in general funds, but go into the annuity fund for the payment of benefits. Moreover, an increase in contributions helps keep that fund in a sound actuarial state.

The actions of the 1984 General Assembly were not only reasonable and enhanced the actuarial and fiscal soundness of the pension systems, but they also resulted in substantial benefits to employees and teachers. First, State employees received a six percent pay raise that automatically translates into higher pension levels in the future. Teachers too received higher pay increases both in 1984 and in future years as a result of the 1984 General Assembly's five-year commitment of $616 million in

increased aid to education. The pay increases will also result in higher pensions for teachers.

Other offsetting benefits are apparent from the 1984 pension reform package. Employees and teachers electing the "bifurcated option" are not obliged to make contributions unless their salary exceeds the Social Security wage base. Old system members will have the future solvency of the system shored up by the General Assembly's decision to use State contributions to the new system to help pay benefits under the old. *See* Chapter 290, Laws of 1984. Finally, capping the COLA will also benefit members of the old system in terms of predictability of costs, financial soundness and future health of the system, and a decline in unfunded accrued liabilities. In fact, under the 1984 statute, the Legislature expressly directed the savings from the measure in Fiscal Year 1985 to be used for reducing unfunded accrued pension liabilities. And this occurred again in FY 1986. Clearly, employees and teachers received sufficient benefits to offset any losses they claim to have incurred.

Finally, Maryland truly believed in 1979 that it had remedied the problems of the retirement systems. It could not have reasonably foreseen early teacher retirements to obtain the unlimited COLA, the astronomical cost-of-living that followed the enactment of the 1979 law, the successful campaign of the unions to discourage transfers into the new systems, or the parade of errors that mushroomed pension costs and unfunded accrued liabilities by billions of dollars. These are unique facts that called upon the Legislature to act. The General Assembly responded in a unique fashion and, in light of the prevailing common law protections afforded public pension benefits in Maryland, addressed this need with a reasonable compromise that took into account, in the greatest way possible, the interests of teachers and employees. The

State submits that review is not necessary by this Court to confirm that result or to consider the many alternate grounds pressed in support of the judgment below.[20]

CONCLUSION

For all of these reasons, the petition for a writ of certiorari should be denied.

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[20] The State advanced additional grounds below that support the judgment that the 1984 law was constitutional, *viz:* (1) that under *Mazor v. Department of Corrections, supra,* and other relevant "law of the place," the 1979 statute could create no contract; (2) that Petitioners, who were neither induced to employment by the alleged 1979 contract nor declined outside employment solely to remain in the old retirement systems, can point to no legally sufficient consideration to support a statutory contract; (3) that the alleged contract of "no change" in benefits was conditioned on the success of the 1979 pension reform legislation and that the failure of reasonable legislative expectations for such reform justified the 1984 changes; and (4) that employees and teachers were justly compensated for any impairment of their rights.